Public Law 97-354
97th Congress

An Act

To revise subchapter S of the Internal Revenue Code of 1954 (relating to small business corporations).

Oct. 19, 1982
[H.R. 6055]

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Subchapter S Revision Act of 1982.
26 USC 1 note.

SECTION 1. SHORT TITLE; AMENDMENT OF 1954 CODE.

(a) SHORT TITLE.—This Act may be cited as the "Subchapter S Revision Act of 1982".

(b) AMENDMENT OF 1954 CODE.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1954.

26 USC 1 *et seq.*

SEC. 2. AMENDMENT OF SUBCHAPTER S.

Subchapter S of chapter 1 is amended to read as follows:

"Subchapter S—Tax Treatment of S Corporations and Their Shareholders

"Part I. In general.
"Part II. Tax treatment of shareholders.
"Part III. Special rules.
"Part IV. Definitions; miscellaneous.

"PART I—IN GENERAL

"Sec. 1361. S corporation defined.
"Sec. 1362. Election; revocation; termination.
"Sec. 1363. Effect of election on corporation.

"SEC. 1361. S CORPORATION DEFINED.

26 USC 1361.

"(a) S CORPORATION DEFINED.—

"(1) IN GENERAL.—For purposes of this title, the term 'S corporation' means, with respect to any taxable year, a small business corporation for which an election under section 1362(a) is in effect for such year.

"(2) C CORPORATION.—For purposes of this title, the term 'C corporation' means, with respect to any taxable year, a corporation which is not an S corporation for such year.

"(b) SMALL BUSINESS CORPORATION.—

"(1) IN GENERAL.—For purposes of this subchapter, the term 'small business corporation' means a domestic corporation which is not an ineligible corporation and which does not—

"(A) have more than 35 shareholders,

"(B) have as a shareholder a person (other than an estate and other than a trust described in subsection (c)(2)) who is not an individual,

"(C) have a nonresident alien as a shareholder, and

"(D) have more than 1 class of stock.

"(2) INELIGIBLE CORPORATION DEFINED.—For purposes of paragraph (1), the term 'ineligible corporation' means any corporation which is—

"(A) a member of an affiliated group (determined under section 1504 without regard to the exceptions contained in subsection (b) thereof),

"(B) a financial institution to which section 585 or 593 applies,

"(C) an insurance company subject to tax under subchapter L,

26 USC 801.

"(D) a corporation to which an election under section 936 applies, or

"(E) a DISC or former DISC.

"(c) SPECIAL RULES FOR APPLYING SUBSECTION (b).—

"(1) HUSBAND AND WIFE TREATED AS 1 SHAREHOLDER.—For purposes of subsection (b)(1)(A), a husband and wife (and their estates) shall be treated as 1 shareholder.

"(2) CERTAIN TRUSTS PERMITTED AS SHAREHOLDERS.—

"(A) IN GENERAL.—For purposes of subsection (b)(1)(B), the following trusts may be shareholders:

"(i) A trust all of which is treated (under subpart E of part I of subchapter J of this chapter) as owned by an individual who is a citizen or resident of the United States.

26 USC 671.

"(ii) A trust which was described in clause (i) immediately before the death of the deemed owner and which continues in existence after such death, but only for the 60-day period beginning on the day of the deemed owner's death. If a trust is described in the preceding sentence and if the entire corpus of the trust is includible in the gross estate of the deemed owner, the preceding sentence shall be applied by substituting '2-year period' for '60-day period'.

"(iii) A trust with respect to stock transferred to it pursuant to the terms of a will, but only for the 60-day period beginning on the day on which such stock is transferred to it.

"(iv) A trust created primarily to exercise the voting power of stock transferred to it.

This subparagraph shall not apply to any foreign trust.

"(B) TREATMENT AS SHAREHOLDERS.—For purposes of subsection (b)(1)—

"(i) In the case of a trust described in clause (i) of subparagraph (A), the deemed owner shall be treated as the shareholder.

"(ii) In the case of a trust described in clause (ii) of subparagraph (A), the estate of the deemed owner shall be treated as the shareholder.

"(iii) In the case of a trust described in clause (iii) of subparagraph (A), the estate of the testator shall be treated as the shareholder.

"(iv) In the case of a trust described in clause (iv) of subparagraph (A), each beneficiary of the trust shall be treated as a shareholder.

"(3) ESTATE OF INDIVIDUAL IN BANKRUPTCY MAY BE SHAREHOLDER.—For purposes of subsection (b)(1)(B), the term 'estate'

includes the estate of an individual in a case under title 11 of the United States Code. 11 USC 101 *et seq.*

"(4) DIFFERENCES IN COMMON STOCK VOTING RIGHTS DISREGARDED.—For purposes of subsection (b)(1)(D), a corporation shall not be treated as having more than 1 class of stock solely because there are differences in voting rights among the shares of common stock.

"(5) STRAIGHT DEBT SAFE HARBOR.—

"(A) IN GENERAL.—For purposes of subsection (b)(1)(D), straight debt shall not be treated as a second class of stock.

"(B) STRAIGHT DEBT DEFINED.—For purposes of this paragraph, the term 'straight debt' means any written unconditional promise to pay on demand or on a specified date a sum certain in money if—

"(i) the interest rate (and interest payment dates) are not contingent on profits, the borrower's discretion, or similar factors,

"(ii) there is no convertibility (directly or indirectly) into stock, and

"(iii) the creditor is an individual (other than a nonresident alien), an estate, or a trust described in paragraph (2).

"(C) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to provide for the proper treatment of straight debt under this subchapter and for the coordination of such treatment with other provisions of this title.

"(6) OWNERSHIP OF STOCK IN CERTAIN INACTIVE CORPORATIONS.—For purposes of subsection (b)(2)(A), a corporation shall not be treated as a member of an affiliated group at any time during any taxable year by reason of the ownership of stock in another corporation if such other corporation—

"(A) has not begun business at any time on or after the date of its incorporation and before the close of such taxable year, and

"(B) does not have taxable income for the period included within such taxable year.

"(d) SPECIAL RULE FOR QUALIFIED SUBCHAPTER S TRUST.—

"(1) IN GENERAL.—In the case of a qualified subchapter S trust with respect to which a beneficiary makes an election under paragraph (2)—

"(A) such trust shall be treated as a trust described in subsection (c)(2)(A)(i), and

"(B) for purposes of section 678(a), the beneficiary of such trust shall be treated as the owner of that portion of the trust which consists of stock in an S corporation with respect to which the election under paragraph (2) is made.

"(2) ELECTION.—

"(A) IN GENERAL.—A beneficiary of a qualified subchapter S trust (or his legal representative) may elect to have this subsection apply.

"(B) MANNER AND TIME OF ELECTION.—

"(i) SEPARATE ELECTION WITH RESPECT TO EACH S CORPORATION.—An election under this paragraph shall be made separately with respect to each S corporation the stock of which is held by the trust.

"(ii) ELECTIONS WITH RESPECT TO SUCCESSIVE INCOME BENEFICIARIES.—If there is an election under this paragraph with respect to any beneficiary, an election under this paragraph shall be treated as made by each successive beneficiary unless such beneficiary affirmatively refuses to consent to such election.

"(iii) TIME, MANNER, AND FORM OF ELECTION.—Any election, or refusal, under this paragraph shall be made in such manner and form, and at such time, as the Secretary may prescribe.

"(C) ELECTION IRREVOCABLE.—An election under this paragraph, once made, may be revoked only with the consent of the Secretary.

"(D) GRACE PERIOD.—An election under this paragraph shall be effective up to 60 days before the date of the election.

"(3) QUALIFIED SUBCHAPTER S TRUST.—For purposes of this subsection, the term 'qualified subchapter S trust' means a trust—

"(A) which owns stock in 1 or more S corporations,

"(B) all of the income (within the meaning of section 643(b)) of which is distributed (or required to be distributed) currently to 1 individual who is a citizen or resident of the United States, and

"(C) the terms of which require that—

"(i) during the life of the current income beneficiary there shall be only 1 income beneficiary of the trust,

"(ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary,

"(iii) the income interest of the current income beneficiary in the trust shall terminate on the earlier of such beneficiary's death or the termination of the trust, and

"(iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to such beneficiary.

"(4) TRUST CEASING TO BE QUALIFIED.—If a qualified subchapter S trust ceases to meet any requirement under paragraph (3), the provisions of this subsection shall not apply to such trust as of the date it ceases to meet such requirements.

26 USC 1362.

"SEC. 1362. ELECTION; REVOCATION; TERMINATION.

"(a) ELECTION.—

"(1) IN GENERAL.—Except as provided in subsection (g), a small business corporation may elect, in accordance with the provisions of this section, to be an S corporation.

"(2) ALL SHAREHOLDERS MUST CONSENT TO ELECTION.—An election under this subsection shall be valid only if all persons who are shareholders in such corporation on the day on which such election is made consent to such election.

"(b) WHEN MADE.—

"(1) IN GENERAL.—An election under subsection (a) may be made by a small business corporation for any taxable year—

"(A) at any time during the preceding taxable year, or

"(B) at any time during the taxable year and on or before the 15th day of the 3d month of the taxable year.

"(2) CERTAIN ELECTIONS MADE DURING 1ST 2½ MONTHS TREATED AS MADE FOR NEXT TAXABLE YEAR.—If—

"(A) an election under subsection (a) is made for any taxable year during such year and on or before the 15th day of the 3d month of such year, but

"(B) either—

"(i) on 1 or more days in such taxable year before the day on which the election was made the corporation did not meet the requirements of subsection (b) of section 1361, or

Ante, p. 1669.

"(ii) 1 or more of the persons who held stock in the corporation during such taxable year and before the election was made did not consent to the election,

then such election shall be treated as made for the following taxable year.

"(3) ELECTION MADE AFTER 1ST 2½ MONTHS TREATED AS MADE FOR FOLLOWING TAXABLE YEAR.—If—

"(A) a small business corporation makes an election under subsection (a) for any taxable year, and

"(B) such election is made after the 15th day of the 3d month of the taxable year and on or before the last day of such taxable year,

then such election shall be treated as made for the following taxable year.

"(c) YEARS FOR WHICH EFFECTIVE.—An election under subsection (a) shall be effective for the taxable year of the corporation for which it is made and for all succeeding taxable years of the corporation, until such election is terminated under subsection (d).

"(d) TERMINATION.—

"(1) BY REVOCATION.—

"(A) IN GENERAL.—An election under subsection (a) may be terminated by revocation.

"(B) MORE THAN ONE-HALF OF SHARES MUST CONSENT TO REVOCATION.—An election may be revoked only if shareholders holding more than one-half of the shares of stock of the corporation on the day on which the revocation is made consent to the revocation.

"(C) WHEN EFFECTIVE.—Except as provided in subparagraph (D)—

"(i) a revocation made during the taxable year and on or before the 15th day of the 3d month thereof shall be effective on the 1st day of such taxable year, and

"(ii) a revocation made during the taxable year but after such 15th day shall be effective on the 1st day of the following taxable year.

"(D) REVOCATION MAY SPECIFY PROSPECTIVE DATE.—If the revocation specifies a date for revocation which is on or after the day on which the revocation is made, the revocation shall be effective on and after the date so specified.

"(2) BY CORPORATION CEASING TO BE SMALL BUSINESS CORPORATION.—

"(A) IN GENERAL.—An election under subsection (a) shall be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

"(B) WHEN EFFECTIVE.—Any termination under this paragraph shall be effective on and after the date of cessation.

"(3) WHERE PASSIVE INVESTMENT INCOME EXCEEDS 25 PERCENT OF GROSS RECEIPTS FOR 3 CONSECUTIVE TAXABLE YEARS AND CORPORATION HAS SUBCHAPTER C EARNINGS AND PROFITS.—

"(A) TERMINATION.—

"(i) IN GENERAL.—An election under subsection (a) shall be terminated whenever the corporation—

26 USC 301.

"(I) has subchapter C earnings and profits at the close of each of 3 consecutive taxable years, and

"(II) has gross receipts for each of such taxable years more than 25 percent of which are passive investment income.

"(ii) WHEN EFFECTIVE.—Any termination under this paragraph shall be effective on and after the first day of the first taxable year beginning after the third consecutive taxable year referred to in clause (i).

"(iii) YEARS TAKEN INTO ACCOUNT.—A prior taxable year shall not be taken into account under clause (i) unless—

"(I) such taxable year began after December 31, 1981, and

"(II) the corporation was an S corporation for such taxable year.

"(B) SUBCHAPTER C EARNINGS AND PROFITS.—For purposes of subparagraph (A), the term 'subchapter C earnings and profits' means earnings and profits of any corporation for any taxable year with respect to which an election under section 1362(a) (or under section 1372 of prior law) was not in effect.

Ante, p. 1672.

"(C) GROSS RECEIPTS FROM SALES OF CAPITAL ASSETS (OTHER THAN STOCK AND SECURITIES).—For purposes of this paragraph, in the case of dispositions of capital assets (other than stock and securities), gross receipts from such dispositions shall be taken into account only to the extent of the capital gain net income therefrom.

"(D) PASSIVE INVESTMENT INCOME DEFINED.—For purposes of this paragraph—

"(i) IN GENERAL.—Except as otherwise provided in this subparagraph, the term 'passive investment income' means gross receipts derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities (gross receipts from such sales or exchanges being taken into account for purposes of this paragraph only to the extent of gains therefrom).

"(ii) EXCEPTION FOR INTEREST ON NOTES FROM SALES OF INVENTORY.—The term 'passive investment income' shall not include interest on any obligation acquired in the ordinary course of the corporation's trade or business from its sale of property described in section 1221(1).

"(iii) TREATMENT OF CERTAIN LENDING OR FINANCE COMPANIES.—If the S corporation meets the requirements of section 542(c)(6) for the taxable year, the term 'passive investment income' shall not include gross receipts for the taxable year which are derived directly

from the active and regular conduct of a lending or finance business (as defined in section 542(d)(1)).

"(iv) TREATMENT OF CERTAIN LIQUIDATIONS.—Gross receipts derived from sales or exchanges of stock or securities shall not include amounts received by an S corporation which are treated under section 331 (relating to corporate liquidations) as payments in exchange for stock where the S corporation owned more than 50 percent of each class of stock of the liquidating corporation.

"(e) TREATMENT OF S TERMINATION YEAR.—

"(1) IN GENERAL.—In the case of an S termination year, for purposes of this title—

"(A) S SHORT YEAR.—The portion of such year ending before the 1st day for which the termination is effective shall be treated as a short taxable year for which the corporation is an S corporation.

"(B) C SHORT YEAR.—The portion of such year beginning on such 1st day shall be treated as a short taxable year for which the corporation is a C corporation.

"(2) PRO RATA ALLOCATION.—Except as provided in paragraph (3), the determination of which items are to be taken into account for each of the short taxable years referred to in paragraph (1) shall be made—

"(A) first by determining for the S termination year—

"(i) the amount of each of the items of income, loss, deduction, or credit described in section 1366(a)(1)(A), and Post, p. 1677.

"(ii) the amount of the nonseparately computed income or loss, and

"(B) then by assigning an equal portion of each amount determined under subparagraph (A) to each day of the S termination year.

"(3) ELECTION TO HAVE ITEMS ASSIGNED TO EACH SHORT TAXABLE YEAR UNDER NORMAL TAX ACCOUNTING RULES.—

"(A) IN GENERAL.—A corporation may elect to have paragraph (2) not apply.

"(B) ALL SHAREHOLDERS MUST CONSENT TO ELECTION.—An election under this paragraph shall be valid only if all persons who are shareholders in the corporation at any time during the S termination year consent to such election.

"(4) S TERMINATION YEAR.—For purposes of this subsection, the term 'S termination year' means any taxable year of a corporation (determined without regard to this subsection) in which a termination of an election made under subsection (a) takes effect (other than on the 1st day thereof).

"(5) TAX FOR C SHORT YEAR DETERMINED ON ANNUALIZED BASIS.—

"(A) IN GENERAL.—The taxable income for the short year described in subparagraph (B) of paragraph (1) shall be placed on an annual basis by multiplying the taxable income for such short year by the number of days in the S termination year and by dividing the result by the number of days in the short year. The tax shall be the same part of the tax computed on the annual basis as the number of

days in such short year is of the number of days in the S termination year.

"(B) SECTION 443(d)(2) TO APPLY.—Subsection (d)(2) of section 443 shall apply to the short taxable year described in subparagraph (B) of paragraph (1).

"(6) OTHER SPECIAL RULES.—For purposes of this title—

"(A) SHORT YEARS TREATED AS 1 YEAR FOR CARRYOVER PURPOSES.—The short taxable year described in subparagraph (A) of paragraph (1) shall not be taken into account for purposes of determining the number of taxable years to which any item may be carried back or carried forward by the corporation.

"(B) DUE DATE FOR S YEAR.—The due date for filing the return for the short taxable year described in subparagraph (A) of paragraph (1) shall be the same as the due date for filing the return for the short taxable year described in subparagraph (B) of paragraph (1) (including extensions thereof).

"(f) INADVERTENT TERMINATIONS.—If—

"(1) an election under subsection (a) by any corporation was terminated under paragraph (2) or (3) of subsection (d),

"(2) the Secretary determines that the termination was inadvertent,

"(3) no later than a reasonable period of time after discovery of the event resulting in such termination, steps were taken so that the corporation is once more a small business corporation, and

"(4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified pursuant to this subsection, agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period,

then, notwithstanding the terminating event, such corporation shall be treated as continuing to be an S corporation during the period specified by the Secretary.

"(g) ELECTION AFTER TERMINATION.—If a small business corporation has made an election under subsection (a) and if such election has been terminated under subsection (d), such corporation (and any successor corporation) shall not be eligible to make an election under subsection (a) for any taxable year before its 5th taxable year which begins after the 1st taxable year for which such termination is effective, unless the Secretary consents to such election.

26 USC 1363.

"SEC. 1363. EFFECT OF ELECTION ON CORPORATION.

"(a) GENERAL RULE.—Except as otherwise provided in this subchapter and in section 58(d), an S corporation shall not be subject to the taxes imposed by this chapter.

"(b) COMPUTATION OF CORPORATION'S TAXABLE INCOME.—The taxable income of an S corporation shall be computed in the same manner as in the case of an individual, except that—

Ante, p. 1677.

"(1) the items described in section 1366(a)(1)(A) shall be separately stated,

"(2) the deductions referred to in section 703(a)(2) shall not be allowed to the corporation, and

"(3) section 248 shall apply.

"(c) ELECTIONS OF THE S CORPORATION.—

"(1) IN GENERAL.—Except as provided in paragraph (2), any election affecting the computation of items derived from an S corporation shall be made by the corporation.

"(2) EXCEPTIONS.—In the case of an S corporation, elections under the following provisions shall be made by each shareholder separately—

"(A) subsection (b)(5) or (d)(4) of section 108 (relating to income from discharge of indebtedness),

"(B) section 163(d) (relating to limitation on interest on investment indebtedness),

"(C) section 617 (relating to deduction and recapture of certain mining exploration expenditures), and

"(D) section 901 (relating to taxes of foreign countries and possessions of the United States).

"(d) DISTRIBUTIONS OF APPRECIATED PROPERTY.—If—

"(1) an S corporation makes a distribution of property (other than an obligation of such corporation) with respect to its stock, and

"(2) the fair market value of such property exceeds its adjusted basis in the hands of the S corporation,

then, notwithstanding any other provision of this subtitle, gain shall be recognized to the S corporation on the distribution in the same manner as if it had sold such property to the distributee at its fair market value.

"PART II—TAX TREATMENT OF SHAREHOLDERS

"Sec. 1366. Pass-thru of items to shareholders.
"Sec. 1367 Adjustments to basis of stock of shareholders, etc.
"Sec. 1368. Distributions.

"SEC. 1366. PASS-THRU OF ITEMS TO SHAREHOLDERS.

26 USC 1366.

"(a) DETERMINATION OF SHAREHOLDER'S TAX LIABILITY.—

"(1) IN GENERAL.—In determining the tax under this chapter of a shareholder for the shareholder's taxable year in which the taxable year of the S corporation ends (or for the final taxable year of a shareholder who dies before the end of the corporation's taxable year), there shall be taken into account the shareholder's pro rata share of the corporation's—

"(A) items of income (including tax-exempt income), loss, deduction, or credit the separate treatment of which could affect the liability for tax of any shareholder, and

"(B) nonseparately computed income or loss.

For purposes of the preceding sentence, the items referred to in subparagraph (A) shall include amounts described in paragraph (4) or (6) of section 702(a).

"(2) NONSEPARATELY COMPUTED INCOME OR LOSS DEFINED.—For purposes of this subchapter, the term 'nonseparately computed income or loss' means gross income minus the deductions allowed to the corporation under this chapter, determined by excluding all items described in paragraph (1)(A).

"(b) CHARACTER PASSED THRU.—The character of any item included in a shareholder's pro rata share under paragraph (1) of subsection (a) shall be determined as if such item were realized directly from the source from which realized by the corporation, or incurred in the same manner as incurred by the corporation.

"(c) GROSS INCOME OF A SHAREHOLDER.—In any case where it is necessary to determine the gross income of a shareholder for purposes of this title, such gross income shall include the shareholder's pro rata share of the gross income of the corporation.

"(d) SPECIAL RULES FOR LOSSES AND DEDUCTIONS.—

"(1) CANNOT EXCEED SHAREHOLDER'S BASIS IN STOCK AND DEBT.—The aggregate amount of losses and deductions taken into account by a shareholder under subsection (a) for any taxable year shall not exceed the sum of—

"(A) the adjusted basis of the shareholder's stock in the S corporation (determined with regard to paragraph (1) of section 1367(a) for the taxable year), and

"(B) the shareholder's adjusted basis of any indebtedness of the S corporation to the shareholder (determined without regard to any adjustment under paragraph (2) of section 1367(b) for the taxable year).

"(2) INDEFINITE CARRYOVER OF DISALLOWED LOSSES AND DEDUCTIONS.—Any loss or deduction which is disallowed for any taxable year by reason of paragraph (1) shall be treated as incurred by the corporation in the succeeding taxable year with respect to that shareholder.

"(3) CARRYOVER OF DISALLOWED LOSSES AND DEDUCTIONS TO POST-TERMINATION TRANSITION PERIOD.—

"(A) IN GENERAL.—If for the last taxable year of a corporation for which it was an S corporation a loss or deduction was disallowed by reason of paragraph (1), such loss or deduction shall be treated as incurred by the shareholder on the last day of any post-termination transition period.

"(B) CANNOT EXCEED SHAREHOLDER'S BASIS IN STOCK.—The aggregate amount of losses and deductions taken into account by a shareholder under subparagraph (A) shall not exceed the adjusted basis of the shareholder's stock in the corporation (determined at the close of the last day of the post-termination transition period and without regard to this paragraph).

"(C) ADJUSTMENT IN BASIS OF STOCK.—The shareholder's basis in the stock of the corporation shall be reduced by the amount allowed as a deduction by reason of this paragraph.

"(e) TREATMENT OF FAMILY GROUP.—If an individual who is a member of the family (within the meaning of section 704(e)(3)) of one or more shareholders of an S corporation renders services for the corporation or furnishes capital to the corporation without receiving reasonable compensation therefor, the Secretary shall make such adjustments in the items taken into account by such individual and such shareholders as may be necessary in order to reflect the value of such services or capital.

"(f) SPECIAL RULES.—

"(1) SUBSECTION (a) NOT TO APPLY TO CREDIT ALLOWABLE UNDER SECTION 39.—Subsection (a) shall not apply with respect to any credit allowable under section 39 (relating to certain uses of gasoline, special fuels, and lubricating oil).

Post, p. 1683.

"(2) REDUCTION IN PASS-THRU FOR TAX IMPOSED ON CAPITAL GAIN.—If any tax is imposed under section 56 or 1374 for any taxable year on an S corporation, for purposes of subsection (a)—

"(A) the amount of the corporation's long-term capital gains for the taxable year shall be reduced by the amount of such tax, and

"(B) if the amount of such tax exceeds the amount of such long-term capital gains, the corporation's gains from sales or exchanges of property described in section 1231 shall be reduced by the amount of such excess.

For purposes of the preceding sentence, the term 'long-term capital gain' shall not include any gain from the sale or exchange of property described in section 1231. "Long-term capital gain."

"(3) REDUCTION IN PASS-THRU FOR TAX IMPOSED ON EXCESS NET PASSIVE INCOME.—If any tax is imposed under section 1375 for any taxable year on an S corporation, for purposes of subsection (a), each item of passive investment income shall be reduced by an amount which bears the same ratio to the amount of such tax as— *Post*, p. 1684.

"(A) the amount of such item, bears to

"(B) the total passive investment income for the taxable year.

"(g) CROSS REFERENCE.—

"For rules relating to procedures for determining the tax treatment of subchapter S items, see subchapter D of chapter 63.

"SEC. 1367. ADJUSTMENTS TO BASIS OF STOCK OF SHAREHOLDERS, ETC. 26 USC 1367.

"(a) GENERAL RULE.—

"(1) INCREASES IN BASIS.—The basis of each shareholder's stock in an S corporation shall be increased for any period by the sum of the following items determined with respect to that shareholder for such period:

"(A) the items of income described in subparagraph (A) of section 1366(a)(1), *Ante*, p. 1677.

"(B) any nonseparately computed income determined under subparagraph (B) of section 1366(a)(1), and

"(C) the excess of the deductions for depletion over the basis of the property subject to depletion.

"(2) DECREASES IN BASIS.—The basis of each shareholder's stock in an S corporation shall be decreased for any period (but not below zero) by the sum of the following items determined with respect to the shareholder for such period:

"(A) distributions by the corporation which were not includible in the income of the shareholder by reason of section 1368,

"(B) the items of loss and deduction described in subparagraph (A) of section 1366(a)(1),

"(C) any nonseparately computed loss determined under subparagraph (B) of section 1366(a)(1),

"(D) any expense of the corporation not deductible in computing its taxable income and not properly chargeable to capital account, and

"(E) the amount of the shareholder's deduction for depletion under section 611 with respect to oil and gas wells.

"(b) SPECIAL RULES.—

"(1) INCOME ITEMS.—An amount which is required to be included in the gross income of a shareholder and shown on his return shall be taken into account under subparagraph (A) or (B) of subsection (a)(1) only to the extent such amount is included in the shareholder's gross income on his return, in-

creased or decreased by any adjustment of such amount in a redetermination of the shareholder's tax liability.

"(2) ADJUSTMENTS IN BASIS OF INDEBTEDNESS.—

"(A) REDUCTION OF BASIS.—If for any taxable year the amounts specified in subparagraphs (B), (C), (D), and (E) of subsection (a)(2) exceed the amount which reduces the shareholder's basis to zero, such excess shall be applied to reduce (but not below zero) the shareholder's basis in any indebtedness of the S corporation to the shareholder.

"(B) RESTORATION OF BASIS.—If for any taxable year there is a reduction under subparagraph (A) in the shareholder's basis in the indebtedness of an S corporation to a shareholder, any net increase (after the application of paragraphs (1) and (2) of subsection (a)) for any subsequent taxable year shall be applied to restore such reduction in basis before any of it may be used to increase the shareholder's basis in the stock of the S corporation.

"(3) COORDINATION WITH SECTION 165(g).—This section and section 1366 shall be applied before the application of section 165(g) to any taxable year of the shareholder or the corporation in which the stock becomes worthless.

Ante, p. 1677.

26 USC 1368.

"SEC. 1368. DISTRIBUTIONS.

"(a) GENERAL RULE.—A distribution of property made by an S corporation with respect to its stock to which (but for this subsection) section 301(c) would apply shall be treated in the manner provided in subsection (b) or (c), whichever applies.

"(b) S CORPORATION HAVING NO EARNINGS AND PROFITS.—In the case of a distribution described in subsection (a) by an S corporation which has no accumulated earnings and profits—

"(1) AMOUNT APPLIED AGAINST BASIS.—The distribution shall not be included in gross income to the extent that it does not exceed the adjusted basis of the stock.

"(2) AMOUNT IN EXCESS OF BASIS.—If the amount of the distribution exceeds the adjusted basis of the stock, such excess shall be treated as gain from the sale or exchange of property.

"(c) S CORPORATION HAVING EARNINGS AND PROFITS.—In the case of a distribution described in subsection (a) by an S corporation which has accumulated earnings and profits—

"(1) ACCUMULATED ADJUSTMENTS ACCOUNT.—That portion of the distribution which does not exceed the accumulated adjustments account shall be treated in the manner provided by subsection (b).

"(2) DIVIDEND.—That portion of the distribution which remains after the application of paragraph (1) shall be treated as a dividend to the extent it does not exceed the accumulated earnings and profits of the S corporation.

"(3) TREATMENT OF REMAINDER.—Any portion of the distribution remaining after the application of paragraph (2) of this subsection shall be treated in the manner provided by subsection (b).

"(d) CERTAIN ADJUSTMENTS TAKEN INTO ACCOUNT.—Subsections (b) and (c) shall be applied by taking into account (to the extent proper)—

"(1) the adjustments to the basis of the shareholder's stock described in section 1367, and

Ante, p. 1679.

"(2) the adjustments to the accumulated adjustments account which are required by subsection (e)(1).

"(e) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

"(1) ACCUMULATED ADJUSTMENTS ACCOUNT.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the term 'accumulated adjustments account' means an account of the S corporation which is adjusted for the S period in a manner similar to the adjustments under section 1367 (except that no adjustment shall be made for income which is exempt from tax under this title and no adjustment shall be made for any expense not deductible in computing the corporation's taxable income and not properly chargeable to capital account). *Ante*, p. 1679.

"(B) AMOUNT OF ADJUSTMENT IN THE CASE OF REDEMPTIONS.—In the case of any redemption which is treated as an exchange under section 302(a) or 303(a), the adjustment in the accumulated adjustments account shall be an amount which bears the same ratio to the balance in such account as the number of shares redeemed in such redemption bears to the number of shares of stock in the corporation immediately before such redemption.

"(2) S PERIOD.—The term 'S period' means the most recent continuous period during which the corporation has been an S corporation. Such period shall not include any taxable year beginning before January 1, 1983.

"PART III—SPECIAL RULES

"Sec. 1371. Coordination with subchapter C.
"Sec. 1372. Partnership rules to apply for fringe benefit purposes.
"Sec. 1373. Foreign income.
"Sec. 1374. Tax imposed on certain capital gains.
"Sec. 1375. Tax imposed when passive investment income of corporation having subchapter C earnings and profits exceeds 25 percent of gross receipts.

"SEC. 1371. COORDINATION WITH SUBCHAPTER C. 26 USC 1371.

"(a) APPLICATION OF SUBCHAPTER C RULES.—

"(1) IN GENERAL.—Except as otherwise provided in this title, and except to the extent inconsistent with this subchapter, subchapter C shall apply to an S corporation and its shareholders.

"(2) S CORPORATION AS SHAREHOLDER TREATED LIKE INDIVIDUAL.—For purposes of subchapter C, an S corporation in its capacity as a shareholder of another corporation shall be treated as an individual.

"(b) NO CARRYOVER BETWEEN C YEAR AND S YEAR.—

"(1) FROM C YEAR TO S YEAR.—No carryforward, and no carryback, arising for a taxable year for which a corporation is a C corporation may be carried to a taxable year for which such corporation is an S corporation.

"(2) NO CARRYOVER FROM S YEAR.—No carryforward, and no carryback, shall arise at the corporate level for a taxable year for which a corporation is an S corporation.

"(3) TREATMENT OF S YEAR AS ELAPSED YEAR.—Nothing in paragraphs (1) and (2) shall prevent treating a taxable year for which a corporation is an S corporation as a taxable year for

purposes of determining the number of taxable years to which an item may be carried back or carried forward.

"(c) EARNINGS AND PROFITS.—

"(1) IN GENERAL.—Except as provided in paragraphs (2) and (3), no adjustment shall be made to the earnings and profits of an S corporation.

"(2) ADJUSTMENTS FOR REDEMPTIONS, LIQUIDATIONS, REORGANIZATIONS, DIVISIVES, ETC.—In the case of any transaction involving the application of subchapter C to any S corporation, proper adjustment to any accumulated earnings and profits of the corporation shall be made.

26 USC 301.

"(3) ADJUSTMENTS IN CASE OF DISTRIBUTIONS TREATED AS DIVIDENDS UNDER SECTION 1368(c)(2).—Paragraph (1) shall not apply with respect to that portion of a distribution which is treated as a dividend under section 1368(c)(2).

Ante, p. 1680.

"(d) COORDINATION WITH INVESTMENT CREDIT RECAPTURE.—

"(1) NO RECAPTURE BY REASON OF ELECTION.—Any election under section 1362 shall be treated as a mere change in the form of conducting a trade or business for purposes of the second sentence of section 47(b).

Ante, p. 1672.

"(2) CORPORATION CONTINUES TO BE LIABLE.—Notwithstanding an election under section 1362, an S corporation shall continue to be liable for any increase in tax under section 47 attributable to credits allowed for taxable years for which such corporation was not an S corporation.

"(e) CASH DISTRIBUTIONS DURING POST-TERMINATION TRANSITION PERIOD.—Any distribution of money by a corporation with respect to its stock during a post-termination transition period shall be applied against and reduce the adjusted basis of the stock, to the extent that the amount of the distribution does not exceed the accumulated adjustments account.

26 USC 1372.

"SEC. 1372. PARTNERSHIP RULES TO APPLY FOR FRINGE BENEFIT PURPOSES.

"(a) GENERAL RULE.—For purposes of applying the provisions of this subtitle which relate to employee fringe benefits—

"(1) the S corporation shall be treated as a partnership, and

"(2) any 2-percent shareholder of the S corporation shall be treated as a partner of such partnership.

"(b) 2-PERCENT SHAREHOLDER DEFINED.—For purposes of this section, the term '2-percent shareholder' means any person who owns (or is considered as owning within the meaning of section 318) on any day during the taxable year of the S corporation more than 2 percent of the outstanding stock of such corporation or stock possessing more than 2 percent of the total combined voting power of all stock of such corporation.

26 USC 1373.

"SEC. 1373. FOREIGN INCOME.

"(a) S CORPORATION TREATED AS PARTNERSHIP, ETC.—For purposes of subparts A and F of part III, and part V, of subchapter N (relating to income from sources without the United States)—

26 USC 901, 951.
26 USC 999.

"(1) an S corporation shall be treated as a partnership, and

"(2) the shareholders of such corporation shall be treated as partners of such partnership.

"(b) RECAPTURE OF OVERALL FOREIGN LOSS.—For purposes of section 904(f) (relating to recapture of overall foreign loss), the making

or termination of an election to be treated as an S corporation shall be treated as a disposition of the business.

"SEC. 1374. TAX IMPOSED ON CERTAIN CAPITAL GAINS. 26 USC 1374.

"(a) GENERAL RULE.—If for a taxable year of an S corporation—

"(1) the net capital gain of such corporation exceeds $25,000, and exceeds 50 percent of its taxable income for such year, and

"(2) the taxable income of such corporation for such year exceeds $25,000,

there is hereby imposed a tax (computed under subsection (b)) on the income of such corporation.

"(b) AMOUNT OF TAX.—The tax imposed by subsection (a) shall be the lower of—

"(1) an amount equal to the tax, determined as provided in section 1201(a), on the amount by which the net capital gain of the corporation for the taxable year exceeds $25,000, or

"(2) an amount equal to the tax which would be imposed by section 11 on the taxable income of the corporation for the taxable year if the corporation were not an S corporation.

No credit shall be allowable under part IV of subchapter A of this chapter (other than under section 39) against the tax imposed by subsection (a). 26 USC 31.

"(c) EXCEPTIONS.—

"(1) IN GENERAL.—Subsection (a) shall not apply to an S corporation for any taxable year if the election under section 1362(a) which is in effect with respect to such corporation for such taxable year has been in effect for the 3 immediately preceding taxable years. *Ante*, p. 1672.

"(2) NEW CORPORATIONS.—Subsection (a) shall not apply to an S corporation if—

"(A) it (and any predecessor corporation) has been in existence for less than 4 taxable years, and

"(B) an election under section 1362(a) has been in effect with respect to such corporation for each of its taxable years.

"(3) PROPERTY WITH SUBSTITUTED BASIS.—If—

"(A) but for paragraph (1) or (2), subsection (a) would apply for the taxable year,

"(B) any long-term capital gain is attributable to property acquired by the S corporation during the period beginning 3 years before the first day of the taxable year and ending on the last day of the taxable year, and

"(C) the basis of such property is determined in whole or in part by reference to the basis of any property in the hands of another corporation which was not an S corporation throughout all of the period described in subparagraph (B) before the transfer by such other corporation and during which such other corporation was in existence,

then subsection (a) shall apply for the taxable year, but the amount of the tax determined under subsection (b) shall not exceed a tax, determined as provided in section 1201(a), on the net capital gain attributable to property acquired as provided in subparagraph (B) and having a basis described in subparagraph (C).

"(d) DETERMINATION OF TAXABLE INCOME.—For purposes of subsections (a)(2) and (b)(2), taxable income of the corporation shall be determined under section 63(a) without regard to—

"(1) the deduction allowed by section 172 (relating to net operating loss deduction), and

26 USC 241

"(2) the deductions allowed by part VIII of subchapter B (other than the deduction allowed by section 248, relating to organization expenditures).

26 USC 1375.

"SEC. 1375. TAX IMPOSED WHEN PASSIVE INVESTMENT INCOME OF CORPORATION HAVING SUBCHAPTER C EARNINGS AND PROFITS EXCEEDS 25 PERCENT OF GROSS RECEIPTS.

"(a) GENERAL RULE.—If for the taxable year an S corporation has—

26 USC 341.

"(1) subchapter C earnings and profits at the close of such taxable year, and

"(2) gross receipts more than 25 percent of which are passive investment income,

then there is hereby imposed a tax on the income of such corporation for such taxable year. Such tax shall be computed by multiplying the excess net passive income by the highest rate of tax specified in section 11(b).

"(b) DEFINITIONS.—For purposes of this section—

"(1) EXCESS NET PASSIVE INCOME.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the term 'excess net passive income' means an amount which bears the same ratio to the net passive income for the taxable year as—

"(i) the amount by which the passive investment income for the taxable year exceeds 25 percent of the gross receipts for the taxable year, bears to

"(ii) the passive investment income for the taxable year.

"(B) LIMITATION.—The amount of the excess net passive income for any taxable year shall not exceed the corporation's taxable income for the taxable year (determined in accordance with section 1374(d)).

Ante, p. 1683.

"(2) NET PASSIVE INCOME.—The term 'net passive income' means—

"(A) passive investment income, reduced by

"(B) the deductions allowable under this chapter which are directly connected with the production of such income (other than deductions allowable under section 172 and part VIII of subchapter B).

"(3) PASSIVE INVESTMENT INCOME; ETC.—The terms 'subchapter C earnings and profits', 'passive investment income', and 'gross receipts' shall have the same respective meanings as when used in paragraph (3) of section 1362(d).

Ante, p. 1672.

"(c) SPECIAL RULES.—

"(1) DISALLOWANCE OF CREDIT.—No credit shall be allowed under part IV of subchapter A of this chapter (other than section 39) against the tax imposed by subsection (a).

26 USC 31.

"(2) COORDINATION WITH SECTION 1374.—If any gain—

"(A) is taken into account in determining passive income for purposes of this section, and

"(B) is taken into account under section 1374,

the amount of such gain taken into account under section 1374 shall be reduced by the portion of the excess net passive income for the taxable year which is attributable (on a pro rata basis) to such gain.

"PART IV—DEFINITIONS; MISCELLANEOUS

"Sec. 1377. Definitions and special rule.
"Sec. 1378. Taxable year of S corporation.
"Sec. 1379. Transitional rules on enactment.

26 USC 1377.

"SEC. 1377. DEFINITIONS AND SPECIAL RULE.

"(a) PRO RATA SHARE.—For purposes of this subchapter—

"(1) IN GENERAL.—Except as provided in paragraph (2), each shareholder's pro rata share of any item for any taxable year shall be the sum of the amounts determined with respect to the shareholder—

"(A) by assigning an equal portion of such item to each day of the taxable year, and

"(B) then by dividing that portion pro rata among the shares outstanding on such day.

"(2) ELECTION TO TERMINATE YEAR.—Under regulations prescribed by the Secretary, if any shareholder terminates his interest in the corporation during the taxable year and all persons who are shareholders during the taxable year agree to the application of this paragraph, paragraph (1) shall be applied as if the taxable year consisted of 2 taxable years the first of which ends on the date of the termination.

"(b) POST-TERMINATION TRANSITION PERIOD.—

"(1) IN GENERAL.—For purposes of this subchapter, the term 'post-termination transition period' means—

"(A) the period beginning on the day after the last day of the corporation's last taxable year as an S corporation and ending on the later of—

"(i) the day which is 1 year after such last day, or

"(ii) the due date for filing the return for such last year as an S corporation (including extensions), and

"(B) the 120-day period beginning on the date of a determination that the corporation's election under section 1362(a) had terminated for a previous taxable year.

"(2) DETERMINATION DEFINED.—For purposes of paragraph (1), the term 'determination' means—

"(A) a court decision which becomes final,

"(B) a closing agreement, or

"(C) an agreement between the corporation and the Secretary that the corporation failed to qualify as an S corporation.

"(c) MANNER OF MAKING ELECTIONS, ETC.—Any election under this subchapter, and any revocation under section 1362(d)(1), shall be made in such manner as the Secretary shall by regulations prescribe.

Ante, p. 1672.

26 USC 1378.

"SEC. 1378. TAXABLE YEAR OF S CORPORATION.

"(a) GENERAL RULE.—For purposes of this subtitle—

"(1) an S corporation shall not change its taxable year to any accounting period other than a permitted year, and

"(2) no corporation may make an election under section 1362(a) for any taxable year unless such taxable year is a permitted year.

"(b) PERMITTED YEAR DEFINED.—For purposes of this section, the term 'permitted year' means a taxable year which—

"(1) is a year ending December 31, or

"(2) is any other accounting period for which the corporation establishes a business purpose to the satisfaction of the Secretary.

"(c) EXISTING S CORPORATIONS REQUIRED TO USE PERMITTED YEAR AFTER 50-PERCENT SHIFT IN OWNERSHIP.—

"(1) IN GENERAL.—A corporation which is an S corporation for a taxable year which includes December 31, 1982, shall not be treated as an S corporation for any subsequent taxable year beginning after the first day on which more than 50 percent of the stock is newly owned stock unless such subsequent taxable year is a permitted year.

"(2) NEWLY OWNED STOCK.—For purposes of paragraph (1), the stock held by any person on any day shall be treated as newly owned stock to the extent that—

"(A) the percentage of the stock of such corporation owned by such person on such day, exceeds

"(B) the percentage of the stock of such corporation owned by such person on December 31, 1982.

"(3) STOCK ACQUIRED BY REASON OF DEATH, GIFT FROM FAMILY MEMBER, ETC.—

"(A) IN GENERAL.—For purposes of paragraph (2), if—

"(i) a person acquired stock in the corporation after December 31, 1982, and

"(ii) such stock was acquired by such person—

"(I) by reason of the death of a qualified transferor,

"(II) by reason of a gift from a qualified transferor who is a member of such person's family, or

"(III) by reason of a qualified buy-sell agreement from a qualified transferor (or his estate) who was a member of such person's family,

then such stock shall be treated as held on December 31, 1982, by the person described in clause (i).

"(B) QUALIFIED TRANSFEROR.—For purposes of subparagraph (A), the term 'qualified transferor' means a person—

"(i) who held the stock in the corporation (or predecessor stock) on December 31, 1982, or

"(ii) who acquired the stock in an acquisition which meets the requirements of subparagraph (A).

"(C) FAMILY.—For purposes of subparagraph (A), the term 'family' has the meaning given such term by section 267(c)(4).

"(D) QUALIFIED BUY-SELL AGREEMENT.—For purposes of subparagraph (A), the term 'qualified buy-sell agreement' means any agreement which—

"(i) has been continuously in existence since September 28, 1982, and

"(ii) provides that on the death of any party to such agreement, the stock in the S corporation held by such party will be sold to surviving parties to such agreement who were parties to such agreement on September 28, 1982.

26 USC 1379.

"SEC. 1379. TRANSITIONAL RULES ON ENACTMENT.

"(a) OLD ELECTIONS.—Any election made under section 1372(a) (as in effect before the enactment of the Subchapter S Revision Act of 1982) shall be treated as an election made under section 1362.

Ante, p. 1669.

"(b) REFERENCES TO PRIOR LAW INCLUDED.—In applying this subchapter to any taxable year beginning after December 31, 1982, any reference in this subchapter to another provision of this subchapter shall, to the extent not inconsistent with the purposes of this subchapter, include a reference to the corresponding provision as in effect before the enactment of the Subchapter S Revision Act of 1982.

"(c) DISTRIBUTIONS OF UNDISTRIBUTED TAXABLE INCOME.—If a corporation was an electing small business corporation for the last preenactment year, subsections (f) and (d) of section 1375 (as in effect before the enactment of the Subchapter S Revision Act of 1982) shall continue to apply with respect to distributions of undistributed taxable income for any taxable year beginning before January 1, 1983.

"(d) CARRYFORWARDS.—If a corporation was an electing small business corporation for the last preenactment year and is an S corporation for the 1st postenactment year, any carryforward to the 1st postenactment year which arose in a taxable year for which the corporation was an electing small business corporation shall be treated as arising in the 1st postenactment year.

"(e) PREENACTMENT AND POSTENACTMENT YEARS DEFINED.—For purposes of this subsection—

"(1) LAST PREENACTMENT YEAR.—The term 'last preenactment year' means the last taxable year of a corporation which begins before January 1, 1983.

"(2) 1ST POSTENACTMENT YEAR.—The term '1st postenactment year' means the 1st taxable year of a corporation which begins after December 31, 1982."

SEC. 3. S CORPORATION TREATED LIKE PARTNERSHIP FOR PURPOSES OF CERTAIN PROVISIONS.

(a) DEPLETION IN THE CASE OF OIL AND GAS WELLS (SECTION 613A).—Subsection (c) of section 613A (relating to exemption for independent producers and royalty owners) is amended by adding at the end thereof the following new paragraph: 26 USC 613A.

"(13) SUBCHAPTER S CORPORATIONS.—

"(A) COMPUTATION OF DEPLETION ALLOWANCE AT SHAREHOLDER LEVEL.—In the case of an S corporation, the allowance for depletion with respect to any oil or gas property shall be computed separately by each shareholder.

"(B) ALLOCATION OF BASIS.—The S corporation shall allocate to each shareholder his pro rata share of the adjusted basis of the S corporation in each oil or gas property held by the S corporation. The allocation shall be made as of the later of the date of acquisition of the property by the S corporation, or the first day of the first taxable year of the S corporation to which the Subchapter S Revision Act of 1982 applies. Each shareholder shall separately keep records of his share of the adjusted basis in each oil and gas property of the S corporation, adjust such share of the adjusted basis for any depletion taken on such property, and use such adjusted basis each year in the computation of his cost depletion or in the computation of his gain or loss on the disposition of such property by the S corporation. In the case of any distribution of oil or gas property to its shareholders by the S corporation, the corporation's adjusted basis in the property shall be an amount equal to the sum

of the shareholders' adjusted bases in such property, as determined under this subparagraph.

"(C) COORDINATION WITH TRANSFER RULE OF PARAGRAPH (9).—For purposes of paragraph (9)—

"(i) an S corporation shall be treated as a partnership, and the shareholders of the S corporation shall be treated as partners, and

"(ii) an election by a C corporation to become an S corporation shall be treated as a transfer of all its properties effective on the day on which such election first takes effect.

"(D) COORDINATION WITH TRANSFER RULE OF PARAGRAPH (10).—For purposes of paragraphs (9) and (10), if an S corporation becomes a C corporation, each shareholder shall be treated as having transferred to such corporation his pro rata share of all the assets of the S corporation."

(b) WINDFALL PROFIT TAX.—

26 USC 4996. (1) Paragraph (1) of section 4996(a) (defining producer) is amended by adding at the end thereof the following new subparagraph:

"(C) SUBCHAPTER S CORPORATIONS.—

"(i) IN GENERAL.—If (but for this subparagraph) an S corporation would be treated as a producer of any crude oil—

"(I) such crude oil shall be allocated among the shareholders of such corporation, and

"(II) any shareholder to whom such crude oil is allocated (and not the S corporation) shall be treated as the producer of such crude oil.

"(ii) ALLOCATION.—Except to the extent otherwise provided in regulations, any allocation under clause (i)(I) shall be determined on the basis of the shareholder's pro rata share (as determined under section 1377(a)) of the income of the corporation."

Ante, p. 1685.

26 USC 4992. (2) Section 4992 (relating to independent producer oil) is amended by adding at the end thereof the following new subsection:

"(f) S CORPORATION TREATED AS PARTNERSHIP.—For purposes of subsections (d) and (e)—

"(1) an S corporation shall be treated as a partnership, and

"(2) the shareholders of the S corporation shall be treated as partners of such partnership."

(c) OPTIONAL WRITEOFF OF CERTAIN TAX PREFERENCES (SECTION 58(i)).—

Ante, p. 417. (1) Subparagraph (C) of section 58(i)(4) (defining nonlimited partnership intangible drilling costs) is amended to read as follows:

"(C) NONLIMITED INTANGIBLE DRILLING COSTS.—For purposes of this paragraph, the term 'nonlimited intangible drilling costs' means any qualified expenditure described in paragraph (2)(C) of an individual which is not allocable to a limited business interest (as defined in section 55(e)(8)(C)) of such individual."

Ante, p. 411.

(2) Subparagraph (D) of section 58(i)(5) is amended—

(A) by adding at the end thereof the following new sentence: "A similar rule shall apply in the case of an S corporation and its shareholders.", and

(B) by striking out "PARTNERS" in the subparagraph heading and inserting in lieu thereof "PARTNERS AND SHAREHOLDERS OF S CORPORATIONS".

(3) The paragraph heading for paragraph (4) of section 58(i) is amended by striking out "INTEREST AS LIMITED PARTNER" and inserting in lieu thereof "LIMITED BUSINESS INTEREST". *Ante*, p. 417.

(d) USED PROPERTY FOR PURPOSES OF INVESTMENT CREDIT (SECTION 48(c)).—Subparagraph (D) of section 48(c)(2) (relating to partnerships) is amended— 26 USC 48.

(1) by adding at the end thereof the following new sentence: "A similar rule shall apply in the case of an S corporation and its shareholders.", and

(2) by striking out "PARTNERSHIPS" in the subparagraph heading and inserting in lieu thereof "PARTNERSHIPS AND S CORPORATIONS".

(e) INCOME FROM DISCHARGE OF INDEBTEDNESS (SECTION 108).—Paragraph (6) of section 108(d) (relating to application of section at partner level) is amended to read as follows: 26 USC 108.

"(6) SUBSECTIONS (a), (b), AND (c) TO BE APPLIED AT PARTNER LEVEL OR S CORPORATION SHAREHOLDER LEVEL.—In the case of a partnership, subsections (a), (b), and (c) shall be applied at the partner level. In the case of an S corporation, subsections (a), (b), and (c) shall be applied at the shareholder level."

(f) ELECTION TO EXPENSE CERTAIN DEPRECIABLE BUSINESS ASSETS (SECTION 179).—Paragraph (8) of section 179(d) (relating to dollar limitation in the case of partnerships) is amended— 95 Stat. 219. 26 USC 179.

(1) by adding at the end thereof the following new sentence: "A similar rule shall apply in the case of an S corporation and its shareholders.", and

(2) by striking out "PARTNERSHIPS" in the paragraph heading and inserting in lieu thereof "PARTNERSHIPS AND S CORPORATIONS".

(g) AMORTIZATION OF REFORESTATION EXPENDITURES (SECTION 194).—Subparagraph (B) of section 194(b)(2) (relating to partnerships) is amended— 26 USC 194.

(1) by adding at the end thereof the following new sentence: "A similar rule shall apply in the case of an S corporation and its shareholders.", and

(2) by striking out "PARTNERSHIPS" in the subparagraph heading and inserting in lieu thereof "PARTNERSHIPS AND S CORPORATIONS".

(h) TREATMENT OF LOSSES AND UNPAID EXPENSES AND INTEREST IN THE CASE OF TRANSACTIONS BETWEEN S CORPORATIONS AND CERTAIN RELATED ENTITIES (SECTION 267(b)).—

(1) Subsection (b) of section 267 (relating to losses, expenses, and interest with respect to transactions between related taxpayers) is amended by adding at the end thereof the following new paragraphs: 26 USC 267.

"(10) An S corporation and a partnership if the same persons own—

"(A) more than 50 percent in value of the outstanding stock of the S corporation, and

"(B) more than 50 percent of the capital interest, or the profits interest, in the partnership;

"(11) An S corporation and another S corporation if the same persons own more than 50 percent in value of the outstanding stock of each corporation; or

"(12) An S corporation and a C corporation, if the same individual owns more than 50 percent in value of the outstanding stock of each corporation."

26 USC 267.

(2) Section 267 is amended by adding at the end thereof the following new subsection:

"(f) SPECIAL RULES FOR UNPAID EXPENSES AND INTEREST OF S CORPORATIONS.—

"(1) IN GENERAL.—In the case of any amount paid or incurred by an S corporation, if—

"(A) by reason of the method of accounting of the person to whom the payment is to be made, the amount thereof is not (unless paid) includible in the gross income of such person, and

"(B) at the close of the taxable year of the S corporation for which (but for this paragraph) the amount would be deductible under section 162, 212, or 163, both the S corporation and the person to whom the payment is to be paid are persons specified in one of the paragraphs of subsection (b),

then no deduction shall be allowed in respect of expenses otherwise deductible under section 162 or 212, or of interest otherwise deductible under section 163, before the day as of which the amount thereof is includible in the gross income of the person to whom the payment is made.

"(2) CERTAIN SHAREHOLDERS, ETC., TREATED AS RELATED PERSONS.—For purposes of applying paragraph (1)—

"(A) an S corporation,

"(B) any person who owns, directly or indirectly, 2 percent or more in value of the outstanding stock of such corporation, and

"(C) any person related (within the meaning of subsection (b) of this section or section 707(b)(1)(A)) to a person described in subparagraph (B),

shall be treated as persons specified in a paragraph of subsection (b).

"(3) SUBSECTION (a)(2) NOT TO APPLY.—Subsection (a)(2) shall not apply to any amount paid or incurred by an S corporation."

(3) Subsection (b) of section 267 is amended by striking out "or" at the end of paragraph (8), and by striking out the period at the end of paragraph (9) and inserting in lieu thereof a semicolon.

(i) WITHHOLDING FROM INTEREST AND DIVIDENDS.—

Ante, p. 579.

(1) Paragraph (1) of section 3453(b) (relating to certain middlemen treated as payors) is amended by striking out "or" at the end of subparagraph (B), by inserting "or" at the end of subparagraph (C), and by inserting after subparagraph (C) the following new subparagraph:

"(D) any S corporation which receives any payment,".

Ante, p. 580.

(2) Subsection (b) of section 3454 (defining dividend) is amended by striking out paragraph (2) and by redesignating paragraph (3) as paragraph (2).

(3) Paragraph (2) of section 3454(b) (as redesignated by paragraph (2)) is amended by inserting "and" at the end of subparagraph (F), by striking out ", and" at the end of subparagraph (G) and inserting in lieu thereof a period, and by striking subparagraph (H).

(4) Subsection (d) of section 31 (as amended by section 302 of the Tax Equity and Fiscal Responsibility Act of 1982) is amended to read as follows:

Ante, p. 585.

"(d) YEAR FOR WHICH CREDIT ALLOWED.—Any credit allowed by this section shall be allowed for the taxable year beginning in the calendar year in which the amount was withheld (or, in the case of subsection (c), in which the wages were received). If more than 1 taxable year begins in a calendar year, such amount shall be allowed as a credit for the last taxable year so beginning."

SEC. 4. TAX TREATMENT OF SUBCHAPTER S ITEMS.

(a) GENERAL RULE.—Chapter 63 (relating to assessment) is amended by adding at the end thereof the following new subchapter:

"Subchapter D—Tax Treatment of Subchapter S Items

"Sec. 6241. Tax treatment determined at corporate level.
"Sec. 6242. Shareholder's return must be consistent with corporate return or Secretary notified of inconsistency.
"Sec. 6243. All shareholders to be notified of proceedings and given opportunity to participate.
"Sec. 6244. Certain partnership provisions made applicable.
"Sec. 6245. Subchapter S item defined.

"SEC. 6241. TAX TREATMENT DETERMINED AT CORPORATE LEVEL. 26 USC 6241

"Except as otherwise provided in regulations prescribed by the Secretary, the tax treatment of any subchapter S item shall be determined at the corporate level.

"SEC. 6242. SHAREHOLDER'S RETURN MUST BE CONSISTENT WITH CORPORATE RETURN OR SECRETARY NOTIFIED OF INCONSISTENCY. 26 USC 6242

"A shareholder of an S corporation shall, on such shareholder's return, treat a subchapter S item in a manner which is consistent with the treatment of such item on the corporate return unless the shareholder notifies the Secretary (at the time and in the manner prescribed by regulations) of the inconsistency.

"SEC. 6243. ALL SHAREHOLDERS TO BE NOTIFIED OF PROCEEDINGS AND GIVEN OPPORTUNITY TO PARTICIPATE. 26 USC 6243

"In the manner and at the time prescribed in regulations, each shareholder in a corporation shall be given notice of, and the right to participate in, any administrative or judicial proceeding for the determination at the corporate level of any subchapter S item.

"SEC. 6244. CERTAIN PARTNERSHIP PROVISIONS MADE APPLICABLE. 26 USC 6244

"The provisions of—

"(1) subchapter C which relate to—

"(A) assessing deficiencies, and filing claims for credit or refund, with respect to partnership items, and

"(B) judicial determination of partnership items, and

"(2) so much of the other provisions of this subtitle as relate to partnership items,

are (except to the extent modified or made inapplicable in regulations) hereby extended to and made applicable to subchapter S items.

26 USC 6245.

"SEC. 6245. SUBCHAPTER S ITEM DEFINED.

"For purposes of this subchapter, the term 'subchapter S item' means any item of an S corporation to the extent regulations prescribed by the Secretary provide that, for purposes of this subtitle, such item is more appropriately determined at the corporate level than at the shareholder level."

(b) CLERICAL AMENDMENT.—The table of subchapters for chapter 63 is amended by adding at the end thereof the following new item:

"SUBCHAPTER D. Tax treatment of subchapter S items."

SEC. 5. TECHNICAL AND CONFORMING AMENDMENTS.

(a) TECHNICAL AMENDMENTS.—

26 USC 44D.

(1) SECTION 44D(d)(9).—Paragraph (9) of section 44D(d) (relating to pass-thru in the case of subchapter S corporations, etc.) is amended to read as follows:

"(9) PASS-THRU IN THE CASE OF ESTATES AND TRUSTS.—Under regulations prescribed by the Secretary, rules similar to the rules of subsection (d) of section 52 shall apply."

26 USC 44E.

(2) SECTION 44E(d)(5).—Paragraph (5) of section 44E(d) (relating to pass-thru in the case of subchapter S corporations, etc.) is amended to read as follows:

"(5) PASS-THRU IN THE CASE OF ESTATES AND TRUSTS.—Under regulations prescribed by the Secretary, rules similar to the rules of subsection (d) of section 52 shall apply."

95 Stat. 241.
26 USC 44F.

(3) SECTION 44F.—

(A) Subparagraph (A) of section 44F(f)(2) (relating to pass-thru in the case of subchapter S corporations, etc.) is amended to read as follows:

"(A) PASS-THRU IN THE CASE OF ESTATES AND TRUSTS.—Under regulations prescribed by the Secretary, rules similar to the rules of subsection (d) of section 52 shall apply."

(B) Clause (iv) of section 44F(g)(1)(B) is amended by striking out "an electing small business corporation (within the meaning of section 1371(b))" and inserting in lieu thereof "an S corporation".

26 USC 46.

(4) SECTION 46(a)(4).—The second sentence of paragraph (4) of section 46(a) (defining liability for tax) is amended by striking out "section 1378 (relating to tax on certain capital gains of subchapter S corporations)," and inserting in lieu thereof "section 1374 (relating to tax on certain capital gains of S corporations),".

Ante, p. 1685.

95 Stat. 229.

(5) SECTION 46(c)(8)(C).—Subparagraph (C) of section 46(c)(8) (relating to special rules for partnerships and subchapter S corporations) is amended by striking out "electing small business corporation (within the meaning of section 1371(b))" and inserting in lieu thereof "S corporation".

(6) SECTION 46(e)(3).—Paragraph (3) of section 46(e) (relating to noncorporate lessors) is amended by striking out "an electing small business corporation (as defined in section 1371)" and inserting in lieu thereof "an S corporation".

26 USC 48.

(7) SECTION 48(e).—Subsection (e) of section 48 (relating to subchapter S corporations) is hereby repealed.

(8) SECTION 48(k)(5)(D)(i).—The second sentence of clause (i) of section 48(k)(5)(D) (relating to allocation of direct production costs) is amended by striking out "an electing small business

corporation (within the meaning of section 1371)" and inserting in lieu thereof "an S corporation".

(9) SECTION 50A(a)(3).—The second sentence of paragraph (3) of section 50A(a) (defining liability for tax) is amended by striking out "section 1378 (relating to tax on certain capital gains of subchapter S corporations)," and inserting in lieu thereof "section 1374 (relating to tax on certain capital gains of S corporations),". 26 USC 50A.

(10) SECTION 50B(d).—Subsection (d) of section 50B (relating to subchapter S corporations) is hereby repealed. 26 USC 50B.

(11) SECTION 52(d).—Section 52 is amended by striking out subsection (d) and by redesignating subsections (e) and (f) as subsections (d) and (e), respectively. 26 USC 52.

(12) SECTION 53(a).—The second sentence of subsection (a) of section 53 (relating to limitation based on amount of tax) is amended by striking out "section 1378 (relating to tax on certain capital gains of subchapter S corporations)," and inserting in lieu thereof "section 1374 (relating to tax on certain capital gains of S corporations),". 26 USC 53.

(13) SECTION 55(e)(8)(C).—Subparagraph (C) of section 55(e)(8) is amended by striking out "an electing small business corporation (as defined in section 1371(b))" and inserting in lieu thereof "an S corporation". *Ante*, p. 411.

(14) SECTION 57(a).—The last sentence of section 57(a) (defining items of tax preference) is amended by striking out "an electing small business corporation (as defined in section 1371(b)) and". 26 USC 57.

(15) SECTION 57(b).—Subsection (b) of section 57 is amended—

(A) by striking out "an applicable corporation" in paragraph (1) and inserting in lieu thereof "a corporation",

(B) by striking out "applicable corporation" in paragraph (2) and inserting in lieu thereof "corporation", and

(C) by striking out paragraph (3).

(16) SECTION 58(d).—Subsection (d) of section 58 (relating to electing small business corporations and their shareholders) is amended to read as follows: 26 USC 58.

"(d) CERTAIN CAPITAL GAINS OF S CORPORATIONS.—If for a taxable year of an S corporation a tax is imposed on the income of such corporation under section 1374, such corporation shall be subject to the tax imposed by section 56, but computed only with reference to the item of tax preference set forth in section 57(a)(9)(B) to the extent attributable to gains subject to the tax imposed by section 1374." *Ante*, p. 1683.

(17) SECTION 62(9).—Paragraph (9) of section 62 (relating to pension, etc., plans of an electing small business corporation) is hereby repealed. 26 USC 62.

(18) SECTION 163(d)(4).—Paragraph (4) of section 163(d) (relating to limitation on interest on investment indebtedness) is amended by striking out subparagraphs (B) and (C) and redesignating subparagraph (D) as subparagraph (B). 26 USC 163.

(19) SECTION 168(f)(8)(B).—Clause (i) of section 168(f)(8)(B) (relating to special rules for leases), as in effect before the enactment of the Tax Equity and Fiscal Responsibility Act of 1982, is amended by striking out "an electing small business corporation (within the meaning of section 1371(b))" and inserting in lieu thereof "an S corporation". 95 Stat. 204. 26 USC 168. *Ante*, p. 324.

Ante, p. 442.

(20) SECTION 168(f).—Subclause (I) of section 168(f)(8)(C)(i) (as added by subsection (a) of section 209 of the Tax Equity and Fiscal Responsibility Act of 1982) is amended by striking out "an electing small business corporation within the meaning of section 1371(b)" and inserting in lieu thereof "an S corporation".

26 USC 170.

(21) SECTION 170(e).—

(A) Subparagraph (A) of section 170(e)(3) (defining qualified contributions) is amended by striking out "an electing small business corporation within the meaning of section 1371(b))" and inserting in lieu thereof "an S corporation)".

95 Stat. 248.

(B) Clause (i) of section 170(e)(4)(D) is amended to read as follows:

"(i) an S corporation,".

26 USC 172.

(22) SECTION 172(f).—Subsection (f) of section 172 (relating to disallowance of net operating loss of electing small business corporations) is hereby repealed.

26 USC 183.

(23) SECTION 183(a).—Subsection (a) of section 183 (relating to activities not engaged in for profit) is amended by striking out "an electing small business corporation (as defined in section 1371(b))" and inserting in lieu thereof "an S corporation".

Ante, p. 432.

(24) SECTION 189(d).—Paragraph (2) of section 189(d) is amended by striking out "an electing small business corporation (within the meaning of section 1371(b))" and inserting in lieu thereof "an S corporation".

26 USC 280.

(25) SECTION 280(a).—The second sentence of subsection (a) of section 280 (relating to certain expenditures incurred in production of films, books, records, or similar property) is amended by striking out "an electing small business corporation (as defined in section 1371(b))," and inserting in lieu thereof "an S corporation,".

26 USC 280A.

(26) SECTION 280A.—

(A) Subsection (a) of section 280A (relating to disallowance of certain expenses in connection with business use of home, rental of vacation homes, etc.) is amended by striking out "an electing small business corporation," and inserting in lieu thereof "an S corporation,".

(B) Paragraph (1) of section 280A(e) is amended by striking out "an electing small business corporation" and inserting in lieu thereof "an S corporation".

(C) Paragraph (2) of section 280A(f) is amended to read as follows:

"(2) PERSONAL USE BY SHAREHOLDERS OF S CORPORATION.—In the case of an S corporation, subparagraphs (A) and (B) of subsection (d)(2) shall be applied by substituting 'any shareholder of the S corporation' for 'the taxpayer' each place it appears."

Ante, p. 423.

(27) SECTION 291.—

(A) Subsections (a) and (b) of section 291 are each amended by striking out "an applicable corporation" each place it appears and inserting in lieu thereof "a corporation".

(B) Subsection (e) of section 291 is amended by striking out paragraph (2) and by redesignating paragraph (3) as paragraph (2).

(28) SECTION 447(C)(1).—Paragraph (1) of section 447(c) (relating to exception for small business and family corporations) is amended to read as follows: 26 USC 447.

"(1) an S corporation,".

(29) SECTION 447(g).—Clause (i) of section 447(g)(4)(A) is amended to read as follows: *Ante*, p. 495.

"(i) an S corporation, or".

(30) SECTION 464(C)(1).—Paragraph (1) of section 464(c) (defining farming syndicate) is amended by striking out "an electing small business corporation (as defined in section 1371(b))" each place it appears and inserting in lieu thereof "an S corporation". 26 USC 464.

(31) SECTION 465.— 26 USC 465.

(A) Paragraph (1) of section 465(a) (relating to deductions limited to amount at risk) is amended by adding "and" at the end of subparagraph (A), by striking out subparagraph (B), and by redesignating subparagraph (C) as subparagraph (B).

(B) Paragraph (3) of section 465(a) is amended—

(i) by striking out "paragraph (1)(C)" and inserting in lieu thereof "paragraph (1)(B)", and

(ii) by striking out "PARAGRAPH (1)(C)" in the paragraph heading and inserting in lieu thereof "PARAGRAPH (1)(B)".

(C) The last sentence of paragraph (2) of section 465(c) is amended—

(i) by striking out "an electing small business corporation" the first place it appears and inserting in lieu thereof "an S corporation", and

(ii) by striking out "an electing small business corporation" the second place it appears and inserting in lieu thereof "the S corporation".

(D) Clause (ii) of section 465(c)(3)(B) is amended by striking out "electing small business corporation (as defined in section 1371(b))" and inserting in lieu thereof "an S corporation".

(E) Subparagraph (A) of section 465(c)(4) is amended by striking out "subsection (a)(1)(C)" and inserting in lieu thereof "subsection (a)(1)(B)".

(32) SECTION 992(d)(7).—Paragraph (7) of section 992(d) (relating to corporations not eligible to be a DISC) is amended to read as follows: 26 USC 992.

"(7) an S corporation."

(33) SECTION 1016(a)(18).—Paragraph (18) of section 1016(a) (relating to adjustments to basis) is amended to read as follows: 26 USC 1016.

"(18) to the extent provided in section 1367 in the case of stock of, and indebtedness owed to, shareholders of an S corporation;".

(34) SECTION 1101(a)(3)(D).—Subparagraph (D) of section 1101(a)(3) (relating to non-pro rata distributions from certain closely held corporations) is amended by striking out "section 1371(a)(1)" and inserting in lieu thereof "section 1361(b)(1)(A)". 26 USC 1101.

(35) SECTION 1212(a).—Subsection (a) of section 1212 (relating to capital loss carrybacks and carryovers of corporations) is amended by striking out paragraph (3) and by redesignating paragraph (4) as paragraph (3). 26 USC 1212.

(36) SECTION 1251(b)(2)(B).—

26 USC 1251.

(A) Subparagraph (B) of section 1251(b)(2) (relating to excess deductions account) is amended—

(i) by striking out "an electing small business corporation (as defined in section 1371(b))," and inserting in lieu thereof "an S corporation,", and

(ii) by striking out "electing small business corporation" each place it appears in the second and third sentences and inserting in lieu thereof "S corporation".

(B) Subparagraph (D) of section 1251(b)(2) is amended by striking out "an electing small business corporation" and inserting in lieu thereof "an S corporation".

26 USC 1254.

(37) SECTION 1254(b)(2).—Paragraph (2) of section 1254(b) (relating to special rules for gain from dispositions of interest in oil, gas, or geothermal property) is amended by striking out "an electing small business corporation (as defined in section 1371(b))," and inserting in lieu thereof "an S corporation,".

95 Stat. 327.
26 USC 1256.

(38) SECTION 1256(e)(3)(B).—Subparagraph (B) of section 1256(e)(3) (defining syndicate) is amended by striking out "an electing small business corporation within the meaning of section 1371(b)" and inserting in lieu thereof "an S corporation".

26 USC 6037.

(39) SECTION 6037.—

(A) Section 6037 (relating to return of electing small business corporation) is amended—

(i) by striking out "Every electing small business corporation (as defined in section 1371(b))" and inserting in lieu thereof "Every S corporation",

(ii) by striking out "and such other information" and inserting in lieu thereof "each shareholder's pro rata share of each item of the corporation for the taxable year, and such other information", and

(iii) by striking out "**ELECTING SMALL BUSINESS CORPORATION**" in the section heading and inserting in lieu thereof "**S CORPORATION**".

(B) The table of sections for subpart A of part III of subchapter A of chapter 61 is amended by striking out "electing small business corporation" in the item relating to section 6037 and inserting in lieu thereof "S corporation".

26 USC 6042.

(40) SECTION 6042(b)(2).—Paragraph (2) of section 6042(b) (defining dividend) is amended to read as follows:

"(2) EXCEPTIONS.—For purposes of this section, to the extent provided in regulations prescribed by the Secretary, the term 'dividend' does not include any distribution or payment—

"(A) by a foreign corporation, or

"(B) to a foreign corporation, a nonresident alien, or a partnership not engaged in a trade or business in the United States and composed in whole or in part of nonresident aliens."

26 USC 6362.

(41) SECTION 6362(f)(7).—Paragraph (7) of section 6362(f) (relating to partnerships, trusts, subchapter S corporations, and other conduit entities) is amended—

(A) by striking out "electing small business corporations (within the meaning of section 1371(a))" in subparagraph (D) and inserting in lieu thereof "S corporations", and

(B) by striking out "SUBCHAPTER S CORPORATIONS," in the paragraph heading.

(42) Section 6661(b).—Subparagraph (B) of section 6661(b)(1) is amended by striking out "an electing small business corporation (as defined in section 1371(b))" and inserting in lieu thereof "an S corporation". *Ante*, p. 614.

(43) Subsection (d) of section 408 of the Employee Retirement Income Security Act of 1974 is amended by striking out "section 1379 of the Internal Revenue Code of 1954" and inserting in lieu thereof "section 1379 of the Internal Revenue Code of 1954 as in effect on the day before the date of the enactment of the Subchapter S Revision Act of 1982". 29 USC 1108.

(b) CLERICAL AMENDMENT.—The table of subchapters for chapter 1 is amended by striking out the item relating to subchapter S and inserting in lieu thereof the following:

"SUBCHAPTER S. Tax treatment of S corporations and their shareholders."

SEC. 6. EFFECTIVE DATES. 26 USC 1361 note.

(a) IN GENERAL.—Except as otherwise provided in this section, the amendments made by this Act shall apply to taxable years beginning after December 31, 1982.

(b) TRANSITIONAL RULES.—

(1) SECTIONS 1379 AND 62(9) CONTINUE TO APPLY FOR 1983.—Sections 1379 and 62(9) of the Internal Revenue Code of 1954 (as in effect before the date of the enactment of this Act) shall remain in effect for years beginning before January 1, 1984.

(2) ALLOWANCE OF EXCLUSION OF DEATH BENEFIT.—Notwithstanding section 241(b) of the Tax Equity and Fiscal Responsibility Act of 1982, in the case of amounts received under a plan of an S corporation, the amendment made by section 239 of such Act shall apply with respect to decedents dying after December 31, 1982. *Ante*, p. 520. *Ante*, p. 514.

(3) NEW PASSIVE INCOME RULES APPLY TO TAXABLE YEARS BEGINNING DURING 1982.—In the case of a taxable year beginning during 1982—

(A) sections 1362(d)(3), 1366(f)(3), and 1375 of the Internal Revenue Code of 1954 (as amended by this Act) shall apply, and *Ante*, pp. 1672, 1677, 1684.

(B) section 1372(e)(5) of such Code (as in effect on the day before the date of the enactment of this Act) shall not apply.

(c) GRANDFATHER RULES.—

(1) SUBSIDIARIES WHICH ARE FOREIGN CORPORATIONS OR DISC'S.—In the case of any corporation which on September 28, 1982, would have been a member of the same affiliated group as an electing small business corporation but for paragraph (3) or (7) of section 1504(b) of the Internal Revenue Code of 1954, subparagraph (A) of section 1361(b)(2) of such Code (as amended by section 2) shall be applied by substituting "without regard to the exceptions contained in paragraphs (1), (2), (4), (5), and (6) of subsection (b) thereof" for "without regard to the exceptions contained in subsection (b) thereof". *Ante*, p. 1669.

(2) CASUALTY INSURANCE COMPANIES.—

(A) IN GENERAL.—In the case of any qualified casualty insurance electing small business corporation—

(i) the amendments made by this Act shall not apply, and

26 USC 1371.
26 USC 831.

(ii) subchapter S (as in effect on July 1, 1982) of chapter 1 of the Internal Revenue Code of 1954 and part III of subchapter L of chapter 1 of such Code shall apply.

(B) QUALIFIED CASUALTY INSURANCE ELECTING SMALL BUSINESS CORPORATION.—The term "qualified casualty insurance electing small business corporation" means any corporation described in section 831(a) of the Internal Revenue Code of 1954 if—

(i) as of July 12, 1982, such corporation was an electing small business corporation and was described in section 831(a) of such Code,

(ii) such corporation was formed before April 1, 1982, and proposed (through a written private offering first circulated to investors before such date) to elect to be taxed as a subchapter S corporation and to be operated on an established insurance exchange, or

(iii) such corporation is approved for membership on an established insurance exchange pursuant to a written agreement entered into before December 31, 1982, and such corporation is described in section 831(a) of such Code as of December 31, 1984.

A corporation shall not be treated as a qualified casualty insurance electing small business corporation unless an election under subchapter S of chapter 1 of such Code is in effect for its first taxable year beginning after December 31, 1984.

Ante, p. 1669.

(3) CERTAIN CORPORATIONS WITH OIL AND GAS PRODUCTION.—

(A) IN GENERAL.—In the case of any qualified oil corporation—

(i) the amendments made by this Act shall not apply, and

(ii) subchapter S (as in effect on July 1, 1982) of chapter 1 of the Internal Revenue Code of 1954 shall apply.

(B) QUALIFIED OIL CORPORATION.—For purposes of this paragraph, the term "qualified oil corporation" means any corporation if—

(i) as of September 28, 1982, such corporation—

(I) was an electing small business corporation, or

(II) was a small business corporation which made an election under section 1372(a) after December 31, 1981, and before September 28, 1982,

(ii) for calendar year 1982, the combined average daily production of domestic crude oil or natural gas of such corporation and any one of its substantial shareholders exceeds 1,000 barrels, and

(iii) such corporation makes an election under this subparagraph at such time and in such manner as the Secretary of the Treasury or his delegate shall prescribe.

(C) AVERAGE DAILY PRODUCTION.—For purposes of subparagraph (B), the average daily production of domestic crude oil or domestic natural gas shall be determined under section 613A(c)(2) of such Code without regard to the last sentence thereof.

(D) SUBSTANTIAL SHAREHOLDER.—For purposes of subparagraph (B), the term "substantial shareholder" means any person who on July 1, 1982, owns more than 40 percent (in value) of the stock of the corporation.

(4) CONTINUITY REQUIRED.—

(A) IN GENERAL.—This subsection shall cease to apply with respect to any corporation after—

(i) any termination of the election of the corporation under subchapter S of chapter 1 of such Code, or *Ante*, p. 1669.

(ii) the first day on which more than 50 percent of the stock of the corporation is newly owned stock within the meaning of section 1378(c)(2) of such Code (as amended by this Act). *Ante*, p. 1685.

(B) SPECIAL RULES FOR PARAGRAPH (2).—

(i) Paragraph (2) shall also cease to apply with respect to any corporation after the corporation ceases to be described in section 831(a) of such Code.

(ii) For purposes of determining under subparagraph (A)(ii) whether paragraph (2) ceases to apply to any corporation, section 1378(c)(2) of such Code (as amended by this Act) shall be applied by substituting "December 31, 1984" for "December 31, 1982" each place it appears therein.

(d) TREATMENT OF EXISTING FRINGE BENEFIT PLANS.—

(1) IN GENERAL.—In the case of existing fringe benefits of a corporation which as of September 28, 1982, was an electing small business corporation, section 1372 of the Internal Revenue Code of 1954 (as added by this Act) shall apply only with respect to taxable years beginning after December 31, 1987. *Ante*, p. 1682.

(2) REQUIREMENTS.—This subsection shall cease to apply with respect to any corporation after whichever of the following first occurs:

(A) the first day of the first taxable year beginning after December 31, 1982, with respect to which the corporation does not meet the requirements of section 1372(e)(5) of such Code (as in effect on the day before the date of the enactment of this Act),

(B) any termination after December 31, 1982, of the election of the corporation under subchapter S of chapter 1 of such Code, or

(C) the first day on which more than 50 percent of the stock of the corporation is newly owned stock within the meaning of section 1378(c)(2) of such Code (as amended by this Act).

(3) EXISTING FRINGE BENEFIT.—For purposes of this subsection, the term "existing fringe benefit" means any employee fringe benefit of a type which the corporation provided to its employees as of September 28, 1982.

Ante, p. 1672.

(e) TREATMENT OF CERTAIN ELECTIONS UNDER PRIOR LAW.—For purposes of section 1362(g) of the Internal Revenue Code of 1954, as amended by this Act (relating to no election permitted within 5 years after termination of prior election), any termination under section 1372(e) of such Code (as in effect on the day before the date of the enactment of this Act) shall not be taken into account.

Approved October 19, 1982.

LEGISLATIVE HISTORY—H.R. 6055:

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